Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262

AT&T SUPPLEMENTAL COMMENTS

Pursuant to the Wireline Competition Bureau's August 5, 2004 Public Notice in this matter (DA 04-2475),[1] AT&T Corp. ("AT&T") submits these supplemental comments regarding its pending petition, filed July 11, 1997, for partial reconsideration of the Commission's *1997 Price Cap Review Order*.[2]

As shown below, this proceeding is not simply another routine housekeeping matter to dispose of pleadings that have languished unaddressed by the Commission for an extended period. Contrary to the apparent implication in the Public Notice, intervening events in the more than six years since the filing of AT&T's reconsideration petition have *not* mooted the need for the Commission to prescribe an

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1 Public Notice, "*Parties Asked to Refresh Record Regarding Reconsideration of Price Cap Performance Review for Local Exchange Carriers Fourth Report and Order and Access Charge Reform Second Report and Order*," CC Docket Nos. 94-1 and 96-262 (Wireline Comp. Bur., August 5, 2004), published at 69 Fed. Reg. 51081 (August 17, 2004).

2 *Price Cap Performance Review for Local Exchange Carriers, Access Charge Reform*, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16,642 (1997) ("*1997 Price Cap Review Order*"), *aff'd in part, rev'd in part sub nom. USTA v. FCC*, 188 F.3d 521 (D.C. Cir. 1999).

effective and reliable price cap system for regulating the interstate access rates of incumbent local exchange carriers ("LECs"). In fact, the need for the Commission to adopt a revised price cap system to complement fundamental reform of the intercarrier compensation system is even more imperative now than it was when AT&T's petition was filed in 1997.

Specifically, AT&T, as part of the Intercarrier Compensation Forum ("ICF"), has submitted a comprehensive plan for intercarrier compensation and universal service reform to replace the current myriad of disparate regulatory regimes that have become unsustainable in light of market changes and technological advances.[3] The *ICF Plan* will facilitate efficient competition, promote the deployment of new technologies, preserve and enhance universal service, and advance consumer interests. Because of these numerous public interest benefits, AT&T strongly supports the *ICF Plan*, and urges the Commission to adopt it promptly for *all* price cap LECs to rationalize the access and universal service regimes. However, if the Commission adopts the *ICF Plan* only for those LECs that have voluntarily agreed to it, then it should also simultaneously implement an efficient price cap mechanism that will adequately protect consumer interests against unjust and unreasonable LEC access rates. Moreover, if for any reason the Commission does not adopt intercarrier and universal service reform as proposed in the *ICF Plan* prior to the expiration of current interim controls on LEC

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[3] *See Ex parte* Letter dated August 16, 2004 to Marlene Dortch, Secretary, FCC, from Gary M. Epstein representing Intercarrier Compensation Forum, in CC Docket No. 01-92, *Developing A Unified Intercarrier Compensation Regime*, ("*ICF Plan*").

access rates, it is all the more imperative that it correct and strengthen the price cap regulatory system.

BACKGROUND STATEMENT

In the *1997 Price Cap Review* order, the Commission revised its then-current price cap regime in several important respects by eliminating the LECs' sharing obligation, prescribing a new historical component of the productivity adjustment (the "X-factor") of 6.0 percent, and retaining in the productivity adjustment the existing consumer productivity dividend ("CPD") of 0.5 percent.[4]

AT&T petitioned for reconsideration of the Commission's decision because, despite the rulings described above, the order was seriously detrimental to interexchange carriers and long distance consumers in certain respects. Specifically, AT&T noted that the Commission had erroneously relied on the LECs' "total company" data as the basis for measuring the LECs' historical productivity, rather than determining that component based solely on "interstate-only" data.[5] AT&T also showed that the Commission had improperly retained the low-end adjustment mechanism for LECs with lower rates of return, while removing the sharing obligation for LECs whose earnings

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[4] Under the sharing mechanism, if a LEC's interstate rate of return exceeded certain specified thresholds, the LEC was required to make a one-time reduction in its rates the following year as a way of "sharing" with consumers the benefits of those unanticipated productivity gains. The CPD reflects an expectation that, because of efficiencies created by the price cap regulatory regime, LEC productivity would grow faster in the future than it would in the past.

[5] *See* Petition of AT&T Corp. for Partial Reconsideration of the Commission's X-Factor Order, filed July 11, 1997, in *Price Cap Performance Review of Local Exchange Carriers; Access Charge Reform*, CC Docket Nos. 94-1 and 96-262 ("*AT&T Pet.*") at 3-12.

substantially exceed the levels prescribed by the Commission.[6] Finally, AT&T showed that the Commission had erred in failing to require price cap LECs to adjust their price cap indices ("PCIs") to the levels that would have been established had the Commission adopted its revised X-factor effective with the 1995 LEC annual tariff filings, instead of only with their 1996 tariff filings as prescribed in the *1997 Price Cap Review*.

As the Public Notice points out, several subsequent events have occurred that bear on the *1997 Price Cap Review*. Several entities, principally price cap LECs, filed petitions with the D.C. Circuit for review of the Commission's order there. In its decision addressing the petitions, the Court of Appeals generally rejected the LECs' challenges but held that the Commission "ha[d] failed to state a coherent theory" supporting its choice of a 6.0 percent historical component of the X-factor.[7] The Court also found that the Commission had not provided a sufficient explanation for its decision to retain the 0.5 percent CPD.[8] Accordingly, the Court remanded the case to the Commission "for further explanation", but it stayed the issuance of the mandate to allow time for the Commission to conduct proceedings to represcribe the X-factor.[9]

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6 *Id.* at 12-15. The low-end adjustment permitted a LEC subject to price cap regulation to raise access charges in future years to make up for earnings shortfalls in a past year.

7 *USTA v. FCC*, 188 F.3d 521, 526 (D.C. Cir. 1999).

8 *Id.* at 527.

9 *Id.* at 526-527; *USTA v. FCC*, Nos. 97-1469 *et al.* (D.C. Cir. June 21, 1999) (order staying issuance of mandate).

Following remand, the Commission instituted a new rulemaking to represcribe the appropriate X-factor.[10] The Commission focused there on three principal issues: (i) how the historical component of the X-factor should be determined, both for the remand period (i.e., 1997-2000), and for the future; (ii) the level at which the CPD should be set; and (iii) how the Commission should correct for prior years when the X-factor was too low.

AT&T and other parties filed extensive submissions in that proceeding addressing all of these issues, and the Commission compiled a full record for decision. While the remand of the *1997 Price Cap Review* was pending, however, the Coalition for Affordable Local and Long Distance Service ("CALLS"), of which AT&T was a member, submitted to the Commission a comprehensive set of reforms to set then-existing carrier access charges at more reasonable levels, to reduce implicit subsidies and to make universal service funding explicit and portable. The Commission adopted the CALLS proposal (with certain modifications from that plan as originally submitted), effective on an interim basis for a five-year period extending through June 30, 2005.[11]

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[10] *Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform*, Further Notice of Proposed Rulemaking in CC Docket Nos. 94-1 and 96-262, 14 FCC Rcd 19,717 (1999) ("*Price Cap Remand NPRM*").

[11] *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long-Distance Users, Federal-State Joint Board on Universal Service*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12,962 (2000) ("*CALLS Order*").

Although those interim rate levels were not mandated for all price cap LECs,[12] all of those carriers elected to adopt those changes to their access charges. Concomitantly, because the *CALLS Order* operated as an amendment to the price cap rules during the five-year term of that plan,[13] the Commission to date has not found it necessary to address and resolve the issues regarding the represcription of the X-factor raised in the *Price Cap Remand NPRM.*

ARGUMENT

The expiration of the *CALLS Order*'s provisions is now less than ten months away, and requires that the Commission immediately confront the need to reform the outmoded rules that now distort the competitive marketplace and hinder technological innovation. The *ICF Plan* represents the only proposed solution to these serious public interest harms that represents a broad consensus from among traditionally divergent interests and comprehensively addresses the full range of integrally related intercarrier compensation, network interconnection and universal service issues that currently operate to the detriment of consumers. The ICF proposal, which AT&T

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[12] The *CALLS Order* provided that access rates of non-electing price cap LECs would be reinitialized on the basis of forward-looking economic cost. *See* 15 FCC Rcd at 12,974, 12,984 (¶¶ 29, 57). Pending the resolution of any such cost proceeding, the *CALLS Order*'s price cap rules were made applicable to all price cap LECs. *Id.* Because all of those carriers elected at that time to be treated under the CALLS proposal, no such cost proceedings were conducted then. Subsequently, one price cap LEC, Iowa Telecom, was permitted to rescind its election to accept the CALLS plan rates. *See Petition for Forbearance of Iowa Telecommunications Services, Inc. D/B/A Iowa Telecom Pursuant to 47 U.S.C. 160(c) from the Deadline for Price Cap Carriers to Elect Interstate Access Rates Based on the CALLS Order or a Forward Looking Cost Study,* CC Docket No. 01-331, Order, 17 FCC Rcd 24319, 24325, ¶¶ 17-18 (2002) ("*Forbearance Order*").

[13] *CALLS Order*, 15 FCC Rcd at 12,984-12,986, ¶¶ 60-62.

strongly supports, provides for a carefully phased-in set of changes to create a unified system for network interconnection, rate restructuring and changes in universal funding. The components of the plan include revisions to the current broken regime that apply to large LECs – which are overwhelmingly regulated under the Commission's price cap rules – as well as changes to rules governing smaller Covered Rural Telephone Companies ("CRTCs") as defined in the plan.

AT&T believes that the *ICF Plan* will function most effectively if it is mandatory for all large LECs, including carriers regulated under the Commission's price cap rules. But if the Commission instead follows the approach previously adopted in the *CALLS Order* and makes any of the *ICF Plan*'s intercarrier compensation provisions elective with price cap carriers (which AT&T believes would seriously disserve the public interest), then the Commission at a minimum must revisit the issues raised in AT&T's reconsideration petition and addressed, but never resolved, in the *Price Cap Remand NPRM* to avoid substantial overstatement of those carriers' future rate levels.[14]

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[14] Such corrections to the price cap rules, while significant, would still be considerably less far-reaching than the Commission has previously proposed in similar circumstances. As noted above, in the *CALLS Order* the Commission required any non-electing price cap LEC to submit a cost study to reduce its access charges to forward-looking economic cost.

A. Computation of the X-factor

First and foremost, as AT&T showed both in its reconsideration petition (at 3-12) and in its filings in the *Price Cap Remand NPRM,*[15] the historical component of the X-factor should be computed using LEC productivity calculated solely on an interstate basis, and not on a total company productivity basis as in the *1997 Price Cap Review*. The Commission has long recognized that the LECs' interstate productivity growth substantially exceeds productivity growth for their local and intrastate services.[16] Overwhelming record evidence demonstrates that reliance on total company TFP (total factor productivity) growth produces a dramatic understatement in the price cap LECs' historical productivity associated with their interstate services and, hence, in the calculation of the X-factor. Indeed, the Commission's own staff study performed in 1999 (with minor technical corrections and refinements proposed by AT&T during the 2000 rulemaking proceeding) demonstrated that appropriately calculating LEC productivity

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15 *See* Comments of AT&T Corp. in *Price Cap Remand NPRM, supra,* filed January 7, 2000 at 5-20 and Appendices A and B ("*AT&T Remand NPRM Comments*"); Reply Comments of AT&T in *id.* filed January 24, 2000 at 2-6 and Reply Appendices A-B ("*AT&T Remand NPRM Reply Comments*"); *Ex parte* Letters in *id.* dated February 18, 24 and 25, 2000 to Magalie Roman Salas, Secretary, FCC, from Patrick H. Merrick, AT&T; *Ex parte* letter in *id.* dated May 30, 2000 to Magalie Roman Salas, FCC, from James P. Young, representing AT&T. Copies of those AT&T filings are attached hereto as Exhibits A through F for the convenience of the Commission.

16 *See Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6798, ¶ 92 (1990) ("*LEC Price Cap Order*") (noting "the more rapid growth in interstate usage results in *higher apparent interstate productivity growth*) (emphasis supplied), *recon.*, 6 FCC Rcd 2637 (1991), *aff'd sub nom. National Rural Telephone Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993).

solely on an interstate basis produced an X-factor of about 10.1 percent for the 1997-2000 period governed by the Court of Appeals' remand, and about 9.5 to 9.6 percent for the period commencing July 1, 2000.[17] AT&T also showed that the Commission should adopt at least a 1.0 percent CPD component of the X-factor equation to reflect a reasonable measure of the difference between the LECs' potential productivity gains under the Commission-prescribed non-sharing regime and the gains under a regulatory approach embodying sharing.[18]

Absent comprehensive reform of its intercarrier compensation regime in the manner proposed in the *ICF Plan*, to fulfill its statutory obligation to assure just, reasonable and nondiscriminatory access rates, the Commission should recompute the price cap carriers' X-factor using interstate-only productivity, and increase the CPD to at least 1.0 percent. If the CALLS plan expires in 2005, without the Commission having adopted the *ICF Plan* in its place, the Commission should reinitialize the price cap LECs' rate levels based on the higher X-factor that should otherwise have been prescribed from 1997-2000, and should also apply the revised X-factor to those carriers' rates on a going

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17 These X-factors are based on the mean and median values shown on Table A5 in Appendix A of *AT&T's Remand NPRM Comments* and represent the X-factors that would result from performing the Commission's staff study on an interstate basis while adhering to the study's methodology in other respects. Nothing in the Court of Appeals 1999 remand order precludes the Commission from calculating the X-factor based on "interstate only" data. The Court there merely upheld -- on no other basis -- the Commission's determination that the record before in it in the 1997 LEC price cap proceeding did not allow meaningful quantification of the difference between interstate and total company productivity growth. *See USTA v. FCC*, 188 F.3d at 528-29.

18 *See AT&T Remand NPRM Comments* at 20-24; *AT&T Remand NPRM Reply Comments* at 8-9.

forward basis.[19] If the Commission instead adopts the *ICF Plan* but allows price cap LECs the option to elect not to have their interstate access rates treated under those provisions, then for the same reasons the Commission should apply the revised X-factor to reinitialize rates of all price cap LECs that make such an election, and should also apply that revised factor to their future rates.

B. Elimination of Low-End Adjustment Mechanism

Although the *CALLS Order* precluded price cap LECs from reliance on the low-end adjustment in the tariff year beginning July 1, 2000 (the inception of the CALLS plan's five-year term), the Commission there declined to bar those carriers from employing the low-end adjustment in future tariff years.[20] In its earlier *LEC Pricing Flexibility Order*,[21] the Commission had required price cap carriers that obtain and exercise pricing flexibility in any of their MSAs to forego the low-end adjustment throughout their holding company's service area. Although the Bell Operating Companies ("BOCs") and other large price cap LECs have sought and been granted

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19 The Commission has ample authority to consider new data and to develop new methodologies when prescribing an X-factor for the 1997-2000 remand period. *See Eastern Carolinas Broadcasting Co. v. FCC*, 762 F.2d 95, 97, 101, n.8, 98-104 (D.C. Cir. 1985) (a remand order "for an explanation" of the Commission's prior decision "simply cannot be read to foreclose the possibility of post-remand submissions"). *See also Amendment of Parts 2, 22 and 25 of the Commission's Rules*, 7 FCC Rcd 266, ¶ 28 & n.68 (1992). And nothing in the *CALLS Order* precludes the Commission from resetting the price cap LECs' rate levels after the expiration of the five-year term of that decision.

20 *See CALLS Order*, 15 FCC Rcd at 13,037, ¶¶ 182-183.

21 *See Access Charge Reform,* 14 FCC Rcd 14221 (1999) ("*LEC Pricing Flexibility Order*").

pricing flexibility, smaller price cap LECs still have not filed for that relief, and thus are still eligible to exercise the low-end adjustment. AT&T's request in its reconsideration petition to eliminate that mechanism for price cap LECs thus has not been mooted by subsequent events.

As AT&T showed in its reconsideration petition, retaining the low-end adjustment mechanism at the same time the Commission has eliminated price cap LEC sharing requirements produces a lopsided regulatory scheme that undermines the objective of incentive regulation by permitting inefficient LECs to recover any alleged earnings shortfalls through increased access rates prospectively, but provides for no concomitant consumer benefit where LECs achieve healthy (and, indeed, often exorbitant) earnings. There can be no justification for maintaining such an asymmetrical and facially illogical regulatory regime.

C. Reinitialization of LEC Access Rates

In the *1997 Price Cap Review* the Commission acknowledged that its interim X-factor, adopted in 1995, "considerably *understates* LEC industry productivity growth" and that "allowing all of the past two years of understated productivity to become permanently ingrained in LEC PCIs would not strike the proper balance between stockholder and ratepayer interests."[22] However, the Commission then determined to

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22 *See* 12 FCC Rcd at 16,713-714, ¶¶ 178-179 (emphasis supplied). The Commission also held that, because the 1995 X-factor was expressly "interim" in nature, LECs had been on notice that a further adjustment in their productivity factor was possible, "perhaps beginning with the 1995 tariff year." *Id.* ¶ 179.

apply the revised X-factor only to the price cap LECs' PCI's for the *1996* tariff year.[23] AT&T showed in its reconsideration petition that the failure to apply the revised factor to the 1995 tariff year as well was without any logical justification and had permanently ingrained an understated rate of productivity growth in those LECs' PCIs. AT&T estimated that the Commission's decision had resulted in an understatement of LEC access rate reductions of at least $368 million in the 1997 tariff year.[24]

The Court of Appeals on review sustained the Commission's determination against a claim by MCI that the Commission was required as a matter of law to reinitialize the LECs' PCIs either back to 1991 (the first year of the LEC price cap regime) or at least for the two year period dating back to 1995[25]. But that ruling is not conclusive on the merits of AT&T's pending reconsideration petition. Nothing in the D.C. Circuit's decision precludes the Commission in the exercise of its discretion from now revisiting its determination in the *1997 Price Cap Review* and correcting the resulting substantial overstatement of LEC access rates embedded in those carriers' price caps.

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23 *Id.*

24 *AT&T Pet.* at 18 and Attachment A.

25 *See USTA v. FCC*, 188 F.3d at 530.

CONCLUSION

For the reasons stated above, none of the issues raised in AT&T's pending reconsideration petition has been mooted by subsequent Commission decisions or other "intervening developments" referred to in the August 5 Public Notice. Because the current intercarrier compensation regime is broken beyond repair and must be replaced, the Commission should move forward promptly to adopt the reform of those rules proposed in the *ICF Plan*. In the absence of such a decision prior to the expiration of the five-year term of the *CALLS Order* next June, or if the Commission allows price cap LECs to opt out of Commission adoption of the *ICF Plan*, the Commission should revise its X-factor, and modify the other features of its LEC price cap plan, in the manner described in AT&T's pending reconsideration petition and related subsequent filings in the *Price Cap Remand NPRM*.

Respectfully submitted,

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